

VZCZCXR08935

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RUEHYG
DE RUEHBW #1604/01 3651251
ZNR UUUUU ZZH
R 311251Z DEC 09
FM AMEMBASSY BELGRADE
TO RUEHC/SECSTATE WASHDC 0532
INFO EUROPEAN POLITICAL COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC

UNCLAS SECTION 01 OF 03 BELGRADE 001604

SENSITIVE
SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [ETRD](#) [PREL](#) [SR](#) [KV](#)

SUBJECT: SERBIA ASSUMES CEFTA PRESIDENCY, BUT KOSOVO POLICY LIKELY TO IMPEDE PROGRESS

SUMMARY

¶11. (U) Two years after ratifying the Central European Free Trade Agreement (CEFTA), the 30 million person free trade market is a key Serbian market, with which Serbia has a trade surplus and a trade volume second only to the EU. For it to further prosper as a market, CEFTA needs to address additional trade issues, such as non-tariff barriers. However, on the eve of assuming the CEFTA Presidency in January 2010, Serbia's refusal to accept the Republic of Kosovo as an equal CEFTA member is blocking both CEFTA development and profits for Serbian businesses. Serbian exporters claim the Kosovo issue costs them millions in lost exports and the increased cost of diverting exports via third countries. CEFTA as an institution could be further undermined as a result of Serbia's rigid Kosovo agenda. END SUMMARY.

Central European Free Trade Agreement

¶12. (U) The Central European Free Trade Agreement (CEFTA), signed in December 2006, replaced 32 bilateral trade agreements. The signatories include Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova, Montenegro, Serbia, and UNMIK/Kosovo. Serbia ratified the agreement in October 2007. Within the 30 million person market, CEFTA has eliminated customs tariffs on industrial goods and significantly liberalized trade in agricultural goods. The most important novelties that CEFTA introduced and did not exist in previous bilateral agreements included: domestic origin of goods, liberalization of the services industry, granting equal treatment to domestic and regional investors, opening the public procurement market, protecting IPR rights, improving dispute resolution mechanisms, and applying WTO-compliant rules. CEFTA also continues to deal with elimination of non-tariff barriers.

Serbia's Trade Surplus With CEFTA Countries

¶13. (U) CEFTA countries, excluding Kosovo, are Serbia's second largest regional foreign trade partner, behind the EU. (Note: Serbia records trade with Kosovo as "domestic" trade.) Unlike its huge trade deficit with the EU that reached \$6.23 billion in 2008, Serbia consistently has a trade surplus with its CEFTA partners

which grew from \$1.36 billion in 2007 to \$1.86 billion in 2008. Even amid the current economic crisis, this surplus reached \$1.17 billion in the first ten months of 2009, with \$2.19 billion in exports and \$987 million in imports. Agricultural products account for the majority of this surplus (e.g., wheat and wheat products, beverages) while Serbia imports from other CEFTA members mostly iron and steel, electricity and non-metallic mineral products. During the first ten months of 2009, non-Kosovo CEFTA trade accounted for 16% of Serbia's total trade, including 30.8% of Serbia's exports and 7.7% of Serbia's imports.

Increased Cooperation with Most CEFTA Members

¶4. (SBU) Aside from favorable trade results, increased interaction with CEFTA partners has paid off in improved personal relationships in neighboring ministries between countries that had recently been in conflict. Assistant Minister of Economy and Serbia's lead trade negotiator, Bojana Todorovic, told us her counterparts in CEFTA countries, particularly in Croatia and Bosnia, had become valued resources providing support and advice on common issues such as WTO negotiations. She said these relationships were particularly useful in strategizing for difficult WTO negotiations, particularly with Ukraine.

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Non-Tariff Barriers (NTBs) Challenge CEFTA

¶5. (U) Despite Serbia's positive trade balance in CEFTA, industry representatives continue to encounter many non-tariff barriers in trading with CEFTA countries. Dejan Jovovic of the Serbian Chamber of Commerce told us on December 16 that a study by the SEE Stability Pact done before it ceased to exist in June 2008 identified approximately one hundred such barriers, including: complicated customs procedures, non-recognition of quality certificates, lack of internationally recognized accreditation and certification bodies, an insufficient number of authorized laboratories and institutions, additional verification of documentation, regulations that are non-compliant with international standards, lack of proper transportation and other infrastructure, corruption and smuggling. Representatives of Serbia's biggest brewery, Apatinska, told us on December 24 that companies exporting to Serbia face a number of NTB's that do not exist when exporting to other CEFTA countries, such as Bosnia. Apatinska representatives attributed Bosnia's attempt to impose higher customs rates in June (since repealed) as retaliation to Serbian NTBs faced by BIH exporters.

Priorities During Serbia's CEFTA Chairmanship

¶6. (SBU) Serbia will assume the one year rotating CEFTA Chairmanship from Montenegro in January 2010 and Todorovic outlined Serbia's CEFTA priorities for its Chairmanship. These included: launching negotiations to liberalize and open the services market, harmonizing investment policies to establish a regional investment market, opening government procurement markets, and reviewing/adopting competition rules that are harmonized with EU rules. Todorovic also highlighted two key constraints to CEFTA progress: Kosovo and the ongoing global financial crisis.

CEFTA Decision Making at a Standstill

¶17. (U) Todorovic told us CEFTA members have made no joint decisions since Kosovo's independence in February 2008. She attributed CEFTA's inertia to the political and legal questions regarding signatory authority for Kosovo. CEFTA rules require consensus so this situation is likely to continue for the foreseeable future, Todorovic said. UNMIK signed CEFTA in 2006 on Kosovo's behalf, prior to Kosovo's independence, which Serbia refuses to recognize. As a result, the Serbian government continues to insist that UNMIK should represent Kosovo at all CEFTA meetings, and insists Serbian delegations walk out of meetings if the UNMIK representative is not present. When asked how Serbia will handle visa issues for Kosovar CEFTA representatives to travel to Serbia this year, Todorovic had no clear response, saying that the Interior Ministry was included in all CEFTA chairmanship preparation meetings so this issue could be resolved.

Industry View: Kosovo Policy Only Hurts Serbia and Serbian Companies

¶18. (U) Despite CEFTA's gains, Serbian businesses are losing revenue and potential customers as a result of the GoS's Kosovo policy. As a result, some Serbian companies are forced to find alternative delivery routes to access the Kosovo market. Apatinska representatives explained that it was impossible for their brewery to export beer directly from Serbia into Kosovo because Serbian authorities prohibit the use of labels that say "exported to the

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State of Kosovo," as required by Kosovo. Apatinska has resolved the issue by exporting beer from its Montenegro plant to Kosovo instead of from Serbia, costing Serbia \$1.5 million in export revenues per year.

COMMENT

¶19. (SBU) Since its inception, Serbia has benefited greatly from CEFTA, and the positive trade balance with CEFTA partners has provided Serbian businesses a much needed cushion during the current economic downturn. CEFTA has also proven to be a good training ground where Serbia can work on legislation, trade practices, and relationships in preparation for WTO and EU accession, with the help of fellow CEFTA members. Serbia's intransigent Kosovo policy, however, threatens to undermine CEFTA decision making and could limit any further deepening of CEFTA. Serbia still has not figured out how it will harmonize its desire for economic expansion with its rigid Kosovo policy. Unless this is resolved CEFTA may become an empty shell of what it was envisioned to be. Serbian exporters and consumers would be the biggest losers if that happened. End Comment.

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